

**STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
MONTGOMERY, ALABAMA**

**REPORT OF EXAMINATION OF**

**OMEGA ONE INSURANCE COMPANY**

**ELBA, ALABAMA**

**AS OF DECEMBER 31, 2004**

**PARTICIPATION:  
SOUTHEASTERN ZONE, NAIC  
ALABAMA**

STATE OF ALABAMA  
COUNTY OF COFFEE

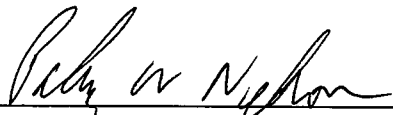
I, Palmer W. Nelson, being first duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

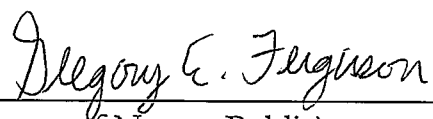
That an examination was made of the affairs and financial condition of Omega One Insurance Company for the period of January 1, 2001, through December 31, 2004;

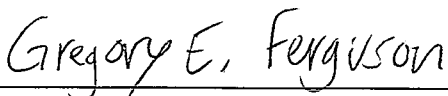
That the following 42 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

And that the statements, exhibits and data therein contained are true and correct to the best of his knowledge and belief.

  
\_\_\_\_\_  
Palmer W. Nelson, CFE

Subscribed and sworn to before the undersigned authority this 20th day of April, 2006.

  
\_\_\_\_\_  
(Signature of Notary Public)

  
\_\_\_\_\_, Notary Public  
(Print Name)

in and for the State of Alabama.

My commission expires 2/28/09

**MY COMMISSION EXPIRES 02-28-09**



**BOB RILEY**  
GOVERNOR

**STATE OF ALABAMA**  
**DEPARTMENT OF INSURANCE**  
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**WALTER A. BELL**  
COMMISSIONER  
ASSISTANT COMMISSIONER  
RAGAN INGRAM  
DEPUTY COMMISSIONERS  
D. DAVID PARSONS  
CHIEF EXAMINER  
RICHARD L. FORD  
STATE FIRE MARSHAL  
ED PAULK  
GENERAL COUNSEL  
RALPH REYN NORMAN  
RECEIVER  
DENISE B. AZAR  
LICENSING MANAGER  
JIMMY W. GUNN

Elba, Alabama  
April 20, 2006

Honorable Mike Geeslin  
Chairman, Examination Oversight Committee  
Insurance Commissioner  
Texas Department of Insurance  
333 Guadalupe Street  
Austin, Texas 78701

Honorable Walter A. Bell, Commissioner  
Secretary Southeastern Zone  
Alabama Department of Insurance  
Post Office Box 303351  
Montgomery, Alabama 36130-3351

Dear Commissioners:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, an examination has been made of the affairs and condition of

Omega One Insurance Company  
Elba, Alabama

as of December 31, 2004, at its home office located at 661 East Davis Street, Elba, Alabama 36323. The report of examination appears herewith.

Where the term "Company" appears herein without qualification, it will be understood to indicate Omega One Insurance Company.

## SCOPE OF EXAMINATION

The Company was last examined for the five year period ended December 31, 2000, by examiners representing the Alabama Department of Insurance. The current examination covers the intervening period from the date of the last examination through December 31, 2004, and was conducted by Alabama Department of Insurance examiners. When deemed appropriate, transactions subsequent to 2004 were reviewed. The examination was made in accordance with the statutory requirements of the Alabama Insurance Code and the Alabama Insurance Department's regulations and bulletins; in accordance with the applicable guidelines and procedures promulgated by the NAIC; and in accordance with generally accepted examination standards and practices in connection with the verification of assets and determination of liabilities.

The examination included an inspection of corporate records, test checks of recorded income and disbursement items for selected periods and a general review of records and files pertaining to operations, administrative practices and compliance with statutes and regulations. Assets were verified and valued and all known liabilities were established or estimated as of December 31, 2004, as shown in the Financial Statements contained herein. However, the discussion of specific assets and liabilities in this report is confined to those items where a change was made by the examiners, or which indicated violation of the Alabama Insurance Code and the Insurance Department's rules and regulations or other insurance laws or rules, or which were deemed by the examiners to require comments or recommendations.

Company office copies of the filed Annual Statements for the years 2001 through 2004 were compared with or reconciled to account balances with respect to ledger items.

The market conduct review consisted of a review of the Company's plan of operation, territory, policy forms and underwriting practices, advertising and marketing, claims, policyholder complaints, agents' licensing practices and compliance with privacy standards.

The Company's accounts were examined by Barfield, Murphy, Shank & Smith, PC, certified public accountants (CPAs), for each of the four years under examination. The examiners reviewed the CPAs audit reports and certain CPAs work papers. The examiners elected to not use any of the work performed by the independent auditor. Further discussion of the work

performed by the CPAs is included in this report under the caption "ACCOUNTS AND RECORDS."

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attested to having valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2004.

## **ORGANIZATION AND HISTORY**

The Company was incorporated on October 22, 1992, under the laws of the State of Alabama as a wholly owned subsidiary of National Security Fire & Casualty Company (NSF&C), an Alabama property and casualty insurance company.

The authorized capital at incorporation was set at \$2,000,000. The Company commenced business with a minimum capitalization of \$1,500,000, which consisted of \$500,000 paid-in capital and \$1,000,000 paid-in surplus, derived from the issuance of 500,000 shares of \$1 par value common stocks at a subscription price of \$3 per share.

In 1994, the Company issued a surplus note in the amount of \$3,500,000 to National Security Insurance Company (NSIC), a life insurer affiliate. The surplus note was approved by the Alabama Department of Insurance on September 29, 1994. The Company increased its capital to \$650,000 on June 14, 1995, by declaring a stock dividend in the amount of \$150,000.

On June 7, 2000, the Company purchased all of the common stock of Liberty Southern Insurance Company (LSIC) for \$.01 per share (approximately \$7,300). Additionally, the Company paid off the outstanding surplus notes of LSIC (approximately \$625,000 including interest) to become the sole shareholder. LSIC's charter to conduct insurance business has been turned in to the Alabama Department of Insurance.

At December 31, 2004, the Company's capital structure consisted of 650,000 shares of common stock, issued and outstanding, with a par value of one dollar per share for a total capital of \$650,000. Paid in and contributed surplus amounted to \$1,000,000. The Company's unassigned funds were \$2,422,772. The Company also had a surplus note outstanding in the amount of \$3,500,000.

The Company's total reported capital and surplus as of December 31, 2004, was \$7,572,772.

## **MANAGEMENT AND CONTROL**

### **Stockholder**

The Company is a wholly owned subsidiary of National Security Fire and Casualty Company (NSF&C). NSF&C is wholly owned by The National Security Group, Inc., a Delaware Corporation.

### **Board of Directors**

The Company's By-Laws provide that its business and affairs will be managed by a Board of Directors comprised of not less than three nor more than seven directors.

The following directors were elected at the March 17, 2004, annual meeting of the Stockholders, and were serving at December 31, 2004:

<u>Director/Residence</u>	<u>Principal Occupation</u>
Jack Edward Brunson Elba, Alabama	President, National Security Fire and Casualty
William Lister Brunson, Jr. Elba, Alabama	President, National Security Insurance Company CEO, National Security Group, Inc.
Mickey Lane Murdock Elba, Alabama	Senior Vice President, National Security Insurance Company
Brian Richard McLeod Elba, Alabama	Secretary, National Security Insurance Company

## Committees

The Company's By-Laws provide that the board of directors may designate from among its members one or more committees which shall have and may exercise all the authority of the board of directors except as set forth in the By-Laws. The only committee serving at December 31, 2004, was the Investment Committee, which was comprised of the following members:

William Lister Brunson, Jr.  
Mickey Lane Murdock  
Brian Richard McLeod

The Investment Committee did not retain minutes of its meetings as required by the ALA. CODE §10-2B-16.01(a)(1975), which states,

A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.

## Officers

The By-Laws specify that the Company's officers shall be a Chairman of the Board, a President, a Vice President, a Secretary and a Treasurer. The Board of Directors may also choose additional Vice Presidents, and an Assistant Secretary and/or an Assistant Treasurer. The officers shall serve at the pleasure of the Board of Directors and shall hold office until their successors are duly elected. Any number of offices may be held by the same person, except the offices of the President and Secretary.

The following officers were elected by the Board of Directors on March 17, 2004, and were serving at December 31, 2004:

<u>Officer</u>	<u>Title</u>
William Lister Brunson, Jr.	Chairman of the Board
Mickey Lane Murdock	Sr. Vice President & Treasurer
Jack Edward Brunson	President
Robert Glover	Vice President

Brian Richard McLeod  
Betty Brunson

Secretary & Assistant Treasurer  
Assistant Secretary

### Management and Service Agreements

The following agreements between the Company and its affiliates were in effect during the examination period and at December 31, 2004:

#### Personnel Agreement

The Company has been operated by National Security Fire & Casualty Company (NSF&C) since its inception. The Company is, therefore, a party to the personnel agreement between National Security Insurance Company (NSIC) and NSF&C. Effective January 1, 1982, NSIC accepted all employees of the Company as employees of NSIC. The Company in turn agreed to reimburse NSIC for all expenses involved in the employment of Company personnel. The purpose of this agreement was to bring Company employees under the benefit plans established by NSIC.

#### Agreement for Allocation of General and Administrative Expenses

Effective January 1, 1982, this agreement provides for allocation of salaries, fringe benefits, employment taxes and other common expenses between National Security Insurance Company (NSIC) and National Security Fire & Casualty Company (NSF&C) on the basis of the ratio of gross written premiums. The agreement also provides that NSF&C will pay NSIC rent for office space based on a formula tied to NSIC's cost in the building and the number of NSF&C employees. This agreement was amended June 1, 1994, to include the Company.

#### Agreement for Claims Adjustment Services

The Company is covered under the agreement between National Security Insurance Company (NSIC) and National Security Fire & Casualty Company (NSF&C), because of its dependence on NSF&C. Effective July 1, 1981, NSIC agreed to provide and train claims adjusters for NSF&C, and to adjust claims for NSF&C and to provide inspection reports on request. NSF&C agreed to reimburse NSIC at industry rates on a monthly basis.



### Tax Allocation Agreement

The tax allocation agreement in effect at December 31, 2004, has been effective since January 1, 1994. It provides that state and federal income taxes will be allocated among the parties on the basis of the actual tax liability. The parties to the agreement include the following:

The National Security Group, Inc. (NSG, holding company)  
National Security Insurance Company  
National Security Fire and Casualty Company  
Omega One Insurance Company  
NATSCO, Inc.

The tax allocation agreement was amended on January 21, 2002, to clarify the arrangement regarding tax related settlements between the parties. Each affiliate's balance each year will be calculated on an individual company basis. NSG will make all federal income tax deposits. In the event that an individual company has a tax benefit that can be used to offset the taxable income of another affiliated company in the consolidated federal tax return, any tax savings generated by the tax benefit will be remitted by the Company utilizing the tax benefit to the affiliate that generated the tax benefit at the applicable federal tax rate utilized by the entity receiving the benefit.

### Catastrophe Reinsurance Agreement

Effective January 1, 2000, National Security Fire & Casualty Company (NSF&C) agreed to reinsure catastrophe losses of the Company in excess of \$250,000 per occurrence. The agreement covers business identified as dwelling fire, allied lines, homeowners and mobile home. In consideration for the premium paid by the Company to NSF&C, NSF&C agreed to maintain catastrophe reinsurance covering catastrophe losses of NSF&C and the Company up to \$16 million subject to retentions and reinstatement premiums to be paid by NSF&C. The Company agreed to pay an annual reinsurance premium to NSF&C equal to 8.75% of net earned premium in consideration for catastrophe reinsurance coverage provided by NSF&C. Further discussion of the catastrophe reinsurance agreement is included in this report under the caption "REINSURANCE – Reinsurance Ceded."

### **Conflict of Interest**

The Company has adopted a policy that requires that any material interests of its directors or officers that conflict, or might conflict, with the interests of the Company be disclosed to its Board of Directors. In order to implement this policy, the Company requires that subject personnel execute conflict of interest statements annually.

Conflict of interest statements were filed by all of the Company's directors and officers for each year under examination, with the following two exceptions. Robert Glover, Vice President, did not file a conflict of interest statement during 2004. Betty Brunson, Assistant Secretary, did not file a conflict of interest statement during 2003 or 2004. No material conflicts were disclosed.

### **CORPORATE RECORDS**

The Company's Articles of Incorporation and By-Laws, as amended, were inspected during the course of the examination and appeared to provide for operation of the Company in accordance with usual corporate practices and applicable statutes and regulations.

Minutes of the meetings of the Stockholder and Board of Directors were reviewed for the period under examination. The minutes appeared to be complete and to adequately document the actions of the respective governing bodies.

### **HOLDING COMPANY AND AFFILIATE MATTERS**

The Company made two unauthorized loans to affiliates during the period covered by the examination.

The Company loaned its parent Company and sole shareholder, National Security Fire & Casualty Company, \$500,000 on November 29, 2004. ALA. CODE §27-41-36 states,

An insurer shall not invest in nor lend its funds upon the security of any note or other evidence of indebtedness of any director, officer or controlling stockholder of the insurer, except as to policy loans

authorized under Section 27-41-25 and except as provided in Sections 27-1-2, 27-27-26 and 27-37-2 of the Alabama Insurance Code.

The November 29, 2004, loan to the Company's sole shareholder and a February 17, 2004, loan to another affiliate within the holding company system, National Security Insurance Company, both exceeded the maximum amount the Company could loan without receiving prior approval of the Commissioner of Insurance. The Company did not seek or receive the approval. The Company violated ALA. CODE §27-29-5(b)(1)(a)(1975), which states,

The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period. (1) Sales, purchases, exchanges, loans or extensions of credit, guarantees, or investments provided the transactions are equal to or exceed: (a) With respect to nonlife insurers, the lesser of three percent of the insurer's admitted assets or 25 percent of surplus as regards policyholders as of the 31st day of December next preceding.

Additionally, the Company did not require its affiliate debtors to adhere to the loan repayment terms provided for in the loan agreements. The Company collected principal only on the settlement date for two loans and did not receive the interest due until 125 days later. The Company was repaid one of the loans 11 days after the agreed upon settlement date.

### **Holding Company**

The Company is deemed to be subject to the Alabama Insurance Holding Company Regulatory Act of 1973, as defined in ALA. CODE §27-29-1(1975), as amended. The Company is responsible for holding company registration and periodic informational filings with the Alabama Department of Insurance.

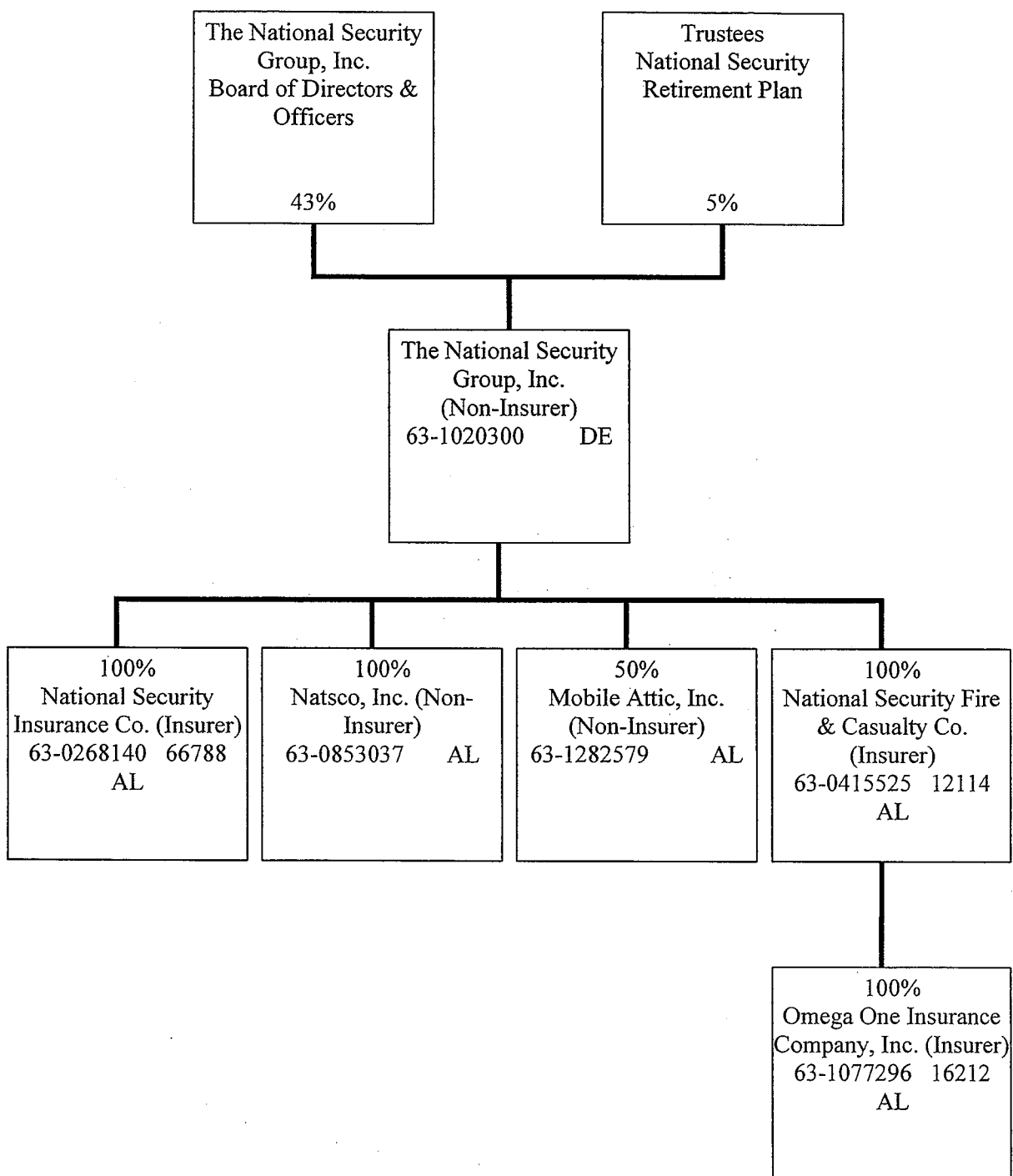
Holding company filings and amendments to registration statements made on behalf of the Company and its affiliates for the years under examination were reviewed. The filings and amendments were found to be appropriate with the exception of the required disclosures related to loans between holding company members. Further discussion of the omission of the required

disclosures of loans between members of a holding company system is included in this report under the caption "HOLDING COMPANY AND AFFILIATE MATTERS."

### **Organizational Chart**

The following chart depicts the insurance holding company system with which the Company was affiliated as of December 31, 2004:

## Organizational Chart



### **Dividends to Stockholders**

The Company did not pay any dividends to its stockholder during the examination period.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company was insured by a Financial Institution Bond issued by Fidelity and Deposit Company of Baltimore, Maryland, at December 31, 2004. The bond provided dishonesty and fraud coverage for salaried officers, employees and persons with employment contracts. The bond did not provide coverage for forgery and alteration of securities. The Company's two insurer affiliates within the holding company system are also covered under the fidelity bond. The limit of coverage is to be applied to losses of all three in the aggregate. The limit of coverage of the fidelity bond did not meet the minimum amount suggested by the NAIC Financial Condition Examiners Handbook. The suggested minimum amount of fidelity bond coverage is from \$700,000 to \$800,000. The limit of coverage for the fidelity bond covering the Company and its two insurer affiliates is \$500,000.

In addition to the fidelity bond coverage, the Company was a named insured under policies providing the following protection at December 31, 2004:

- Commercial Property
- Electronic Data Processing Coverage
- Comprehensive Business Liability
- Comprehensive Automobile Fleet
- Comprehensive Business Umbrella Policy
- Boiler and Machinery
- Workers' Compensation
- Employment Liability
- Fiduciary Liability
- Directors' and Officers' Liability
- Outside Directorship Liability

The coverage and limits of the Company's insurance were reviewed and were deemed to adequately protect the Company's interest.

## **EMPLOYEE AND AGENT WELFARE**

The Company did not have any employees at December 31, 2004; therefore, it had no employee benefit plans. All functions of the Company were performed by employees of National Security Insurance Company via administrative service agreements and certain functions performed by agents acting under the authority of agency agreements.

## **STATUTORY DEPOSITS**

At December 31, 2004, as required or permitted by law, the Company maintained deposits with the respective statutory authorities as follows:

<u>State</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Alabama (1)	\$200,000	\$200,383	\$195,729
Louisiana	\$520,000	\$511,401	\$556,290

(1) Held for the protection of all policyholders.

## **FINANCIAL CONDITION/GROWTH OF THE COMPANY**

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review:

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004*</u>
Admitted Assets	\$10,202,028	\$10,091,989	\$11,121,652	\$11,944,049
Liabilities	5,201,611	4,436,105	4,430,274	4,086,710
Common Capital Stock	650,000	650,000	650,000	650,000
Surplus Note	3,500,000	3,500,000	3,500,000	3,500,000
Paid in and Contributed Surplus	1,000,000	1,000,000	1,000,000	1,000,000
Unassigned Funds	(149,583)	505,885	1,541,378	2,707,339
Gross Written Premium	4,416,546	5,185,556	5,028,995	4,265,931

\*Per Examination

## **MARKET CONDUCT ACTIVITIES**

### **Plan of Operation**

Omega One Insurance Company has two insurance programs that are marketed through two agencies. The two programs are a private passenger automobile program written by Gulf Life Administrators of Mobile, Alabama and a comprehensive mobile homeowners program written by First Premium Insurance Group of Covington, Louisiana.

### **Territory**

At December 31, 2004, the Company was licensed to transact business in the states of Alabama and Louisiana. The certificates of authority from the respective jurisdictions were inspected and found to be in order.

### **Policy Forms and Underwriting**

#### **Policy Forms**

The examination indicated that all forms and endorsements and premium rates utilized in Alabama during the examination period had been properly filed with the Alabama Department of Insurance.

#### **Underwriting Practices**

A review of relevant underwriting information was performed. This included reviewing the underwriting guidelines, declination procedures and cancellation procedures. The examination indicated that the Company consistently applied its underwriting guidelines and no unfair discriminatory practices were used.

The Company did not have any declined/rejected applications because Company officials indicated that the Company's agents issue policies for all applications received and subsequently gives a notice of cancellation if the insured does not meet underwriting guidelines. A review of a sample of 50 policies that were canceled due to underwriting reasons that was selected from a population of 2,271 policy cancellations due to underwriting reasons during



the examination period was performed. The examiners determined that the Company used valid reasons for cancellations due to underwriting decisions for 49 of the underwriting cancellations and no unfairly discriminatory practices were used. One file was apparently misfiled and did not belong in the sample.

A sample of 100 company-initiated cancellations that were canceled due to nonpayment of premium, insufficient funds and underwriting reasons was selected from a population of 15,206 such cancellations during the examination period. The examination of the sample indicated that the reasons for cancellations/non-renewals were valid and in accordance with policy provisions and state law. Out of this sample of 100 cancellations, ninety of the notices of cancellation were valid according to policy provisions and state law. However, the Company was unable to locate ten of the notices of cancellation. Therefore, the examiner could not determine that the remaining ten notices of cancellation were valid according to policy provisions and state law. The Company was not in compliance with ALA. CODE §27-27-29(a)(1975), which states, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

### **Advertising and Marketing**

The National Security Group, Inc. (NSG), the holding company, did general corporate advertising without including any specific product. The Company filed certificates of compliance for all years under examination stating that the advertisements, which were disseminated by or on behalf of the Company, complied, or were made to comply, with the provisions of the statutes of the State of Alabama.

The Company maintains a general purpose web site (hosted by NSG). The web site is designed to provide information about products, employment opportunities, claim reporting, contact options and agency listings. Agents are not authorized to maintain separate individual web sites. It was determined that the Company's internet advertising was not misleading and contained appropriate language to identify the policy form(s) that was being advertised in accordance with applicable statutes, rules and regulations.

## **Claims Review**

Closed claim files reviewed during the examination indicated that claims were being paid in accordance with policy provisions and that settlements were made promptly upon receipt of evidence of the Company's liability. The Company resisted payment only in cases where there appeared to be justifiable cause for further investigation or denial. However, noteworthy discrepancies were found.

A sample was taken from the total number of claims paid during the examination period. A sample of 100 paid claims was selected from 14,516 claims paid during the examination period. The claim files for each sample selection were reviewed to determine whether the claim files included proper documentation. It was noted that nine of the files in the sample could not be located. Two of the files reviewed lacked adequate documentation to evidence the claim resolution decision made. ALA. ADMIN. CODE 482-1-125.-04(a) states,

The insurer shall maintain claim files that are accessible and retrievable for examination... This data must be available for all open and closed files for the current year and the five (5) preceding years, in order to permit reconstruction of the insurer's activities relative to each claim.

## **Policyholder Complaints**

The Company listed seven complaints on its complaint record for the exam period. These complaints were not exclusive to the Alabama territory, and included complaints from policyholders in Louisiana and Mississippi. During the examination period, there were ten complaints received by the Alabama Department of Insurance regarding the Company. The Company is not notified of each complaint that is filed with the Alabama Department of Insurance.

The review of the complaint files indicated that policyholders' issues were addressed in a timely manner and the Company's responses properly addressed the issues raised by the complainant.

## Compliance with Agents' Licensing Requirements

The Company had 260 licensed agents at December 31, 2004. There were 251 agents appointed in Alabama.

The examiners compared the Company's list of licensed and appointed agents with the list provided by the Alabama Department of Insurance. Additionally, the examiners selected a sample of 50 new policies issued from 3,537 new policies issued during 2004 to determine whether all producers were properly licensed and appointed. The review of the sample identified twelve agents that were not appointed in accordance with ALA. CODE §27-7-30(a)(1975).

However, upon further examination, it was determined that each of the twelve agents wrote occasional business and submitted it through an appointed agent, in accordance with ALA. CODE §27-7-34(a), which states, "On an occasional basis, a producer may place with an insurer for which he or she is not appointed only a kind of insurance or classification thereof for which the producer is licensed by placing the insurance through a duly appointed producer of the insurer." Regulation No. 58 §III defines occasional business as follows: "Any agent submitting to another agent under the authority of 27-7-34 shall not submit to the accepting agent on a 'cash with application basis' more than 10 policies in any more calendar month..."

The Company's business is produced by two general agencies involving two insurance programs. The examination indicated that one of the agencies, First Premium Insurance Group, Inc., of Covington, Louisiana, was a managing general agent (MGA) as described by ALA. CODE §27-6A-2(1975) and ALA. ADMIN. CODE 482-1-106-.03(2002). A critical fact in making the determination that the agent was an MGA is that the agent has been given claims settlement authority up to a limit of \$1,500 per claim. Any claims authority of a foreign agency of an Alabama domiciled insurer meets the stipulated criteria of an MGA. The agent was not properly licensed as a managing general agent as required by ALA. CODE §27-6A-3(b)(1975), which states,

No person, firm, association, or corporation shall act in the capacity of a managing general agent representing an insurer domiciled in this state with respect to risks located outside this state unless then licensed in this state as a managing general agent of the insurer. Where applicable, the license may be a nonresident license pursuant to this chapter.

Additionally, ALA. CODE §27-6A-7(a)(1975) states, in part, "If the commissioner finds after a hearing conducted in accordance with section 27-2-28, that any person has violated this chapter, the commissioner may order: (1) For each separate violation, a penalty in the amount up to \$5,000."

It was noted that the Company is contingently liable for a fine in an amount up to \$5,000 because its managing general agent was not properly licensed.

### **Privacy Standards**

The Company does not share customers' private information with any nonaffiliated third parties except those permitted under Sections 14, 15 and 16 of ALA. ADMIN. CODE 482-1-122. The Company had adequate controls in place for persons that handled personal information. As for the private information shared among the affiliated entities, the Company provided notices to its customers that indicated the types of information collected, the way it was used, and the manner in which it was collected.

### **REINSURANCE**

#### **Reinsurance Assumed**

The Company did not assume any reinsurance within the examination period.

#### **Reinsurance Ceded**

In 1996, the Company was added as a reinsured to property catastrophe reinsurance that was in effect for the Company's parent National Security Fire and Casualty Company (NSF&C). The contract provides for coverage of catastrophe losses of the two companies, in the aggregate. A target examination of the Company as of September 30, 1999, indicated that this reinsurance did not provide adequate coverage, considering the Company's financial condition. In order to comply with recommendations of the target examination, effective January 1, 2000, NSF&C agreed to reinsure the Company for catastrophe losses in excess of \$250,000 per occurrence.

At December 31, 2004, the Company had two reinsurance agreements in effect. Each of the agreements provided catastrophe coverage. The specifics of each of the reinsurance agreements are as follows.

**Catastrophe Reinsurance Agreement with National Security Fire & Casualty Company**

Business Covered - Dwelling and commercial fire, allied lines, homeowners and mobile homes.

Term - Effective for the year beginning January 1, 2000, without expiration.

Retention and Limits - National Security Fire & Casualty Company (NSF&C) agrees to reinsure catastrophe losses of the Company in excess of \$250,000 per occurrence. Per the original agreement, NSF&C will maintain catastrophe reinsurance covering losses of NSF&C and the Company up to \$16 million subject to co-reinsurance premiums to be paid by NSF&C. However, at year-end 2004, NSF&C and the Company were reinsured up to \$35 million.

The Company revised its catastrophe reinsurance agreement with NSF&C effective January 1, 2002. The revised catastrophe reinsurance agreement does not contain a provision for premiums and losses and payment of losses reporting as specified by SSAP No. 62, paragraph 8(d). Also, the revised agreement does not contain an errors and omissions clause.

The Company did not require NSF&C to pay its obligations due the Company under the catastrophe reinsurance agreement between the parties. Under the terms of the catastrophe reinsurance agreement, NSF&C agreed to reimburse the Company for catastrophe losses exceeding \$250,000 for any one occurrence. For CAT Occurrence 74, which occurred in October 2002, the Company incurred catastrophe losses in excess of \$605,000 including losses and loss adjustment expenses. The Company allowed NSF&C to ignore its obligation of \$355,709 to reimburse the Company for valid losses and related expenses. Further discussion of the balance due the Company from NSF&C is included in this report under the caption "NOTES TO FINANCIAL STATEMENTS."

**Catastrophe Excess Reinsurance Contract (four layers)**

The Company was added as a reinsured in 1996, to this agreement, which previously covered only National Security Fire & Casualty Company (NSF&C).

The limits of the reinsurance are applicable to combined losses of the Company and NSF&C. The pertinent terms of the reinsurance contract are described as follows:

Business Covered - Dwelling and commercial fire, allied lines, homeowners, mobile homes, inland marine and special multi-peril.

Term - Effective January 1, 2004, to January 1, 2005, with respect to all losses occurring (or beginning) during the term of the contract.

Retention and Limits:

First Layer - 95% of \$3,000,000 or \$2,850,000 each occurrence, in excess of \$2,000,000, not to exceed 95% of \$6,000,000 or \$5,700,000, in respect to all loss occurrences during the term of the agreement.

Second Layer - 95% of \$5,000,000 or \$4,750,000 each occurrence, in excess of \$5,000,000, not to exceed 95% of \$10,000,000 or \$9,500,000, in respect to all loss occurrences during the term of the agreement.

Third Layer - 95% of \$7,500,000 or \$7,125,000 each occurrence, in excess of \$10,000,000, not to exceed 95% of 15,000,000 or \$14,250,000, with respect to all loss occurrences during the term of the agreement.

Fourth Layer - 100% of \$17,500,000 each occurrence, in excess of \$17,500,000, not to exceed 100% of \$35,000,000 with respect to all loss occurrences during the term of the agreement.

Reinsurers and percentage of participation:

	<u>1st Layer</u>	<u>2nd Layer</u>	<u>3rd Layer</u>	<u>4th Layer</u>
Ace Tempest Reinsurance Limited	7.00%	7.00%	NIL	2.00%
IPCRe Underwriting Services Limited on behalf of Allied World Assurance Company Limited	25.00%	15.00%	17.50%	17.50%
American Agricultural Insurance Company	3.00%	3.00%	2.00%	3.00%
AXA Re	2.00%	2.00%	5.00%	5.00%
Dorinco Reinsurance	6.00%	6.00%	NIL	NIL
Hannover Re (Bermuda)				

Limited	NIL	3.00%	10.00%	10.00%
IPCRe Limited	25.00%	15.00%	17.50%	17.50%
Montpelier Reinsurance Ltd	6.00%	10.00%	NIL	NIL
MS Frontier Reinsurance Limited	NIL	NIL	NIL	10.00%
Regional Treaty Services Facility 2003/2004	3.00%	2.00%	7.00%	2.00%
Reinsurance Reinsurance Ltd.	NIL	2.00%	NIL	2.00%
Shelter Mutual Insurance Company	1.50%	1.50%	2.00%	2.00%
Transatlantic Reinsurance Company	NIL	14.00%	NIL	NIL
Across the Board Facility (2004)	1.50%	1.00%	8.00%	3.00%
Lloyd's Underwriter Syndicates	20.0%	18.50%	31.00%	26.00%
	100.00%	100.00%	100.00%	100.00%

All reinsurers were rated A- or higher by Best's Insurance Reports or were rated B or higher by Moody's.

### **Reinsurance Intermediary**

The property catastrophe reinsurance is administered by reinsurance intermediary Guy Carpenter, Roswell, Georgia. Interest and liabilities contracts with the subscribing reinsurers are provided as follows:

1. Guy Carpenter is recognized as the intermediary negotiating the agreement.
2. All communications between the parties shall be transmitted through the intermediary.
3. Payments by the Company to the intermediary shall be deemed to constitute payment to the reinsurers. Payments by the reinsurers to the intermediary shall be deemed to constitute payment to the Company, only to the extent that such payments are actually received by the Company.

### Insolvency Clause

The property catastrophe reinsurance contract contained the usual insolvency clause, which provides for reinsurance payments to a liquidator, receiver or statutory successor without diminution because of the insolvency of the ceding insurer.

## ACCOUNTS AND RECORDS

The Company's principal accounting records are maintained by computer with certain subsidiary records maintained manually. Generally, the Company's records were adequate to reflect the Company's transactions during the examination period and its financial condition at December 31, 2004. However, the examiners encountered several minor instances of incomplete or inconsistent records and accounting errors. Further discussion of these immaterial errors is included in this report under the caption "Notes to Financial Statements."

### Records not Maintained at the Company's Home Office

The examiners found that the Company's policy files pertaining to certain business were located at the offices of the producing agency in Mobile, Alabama, in violation of ALA. CODE §27-27-29(a)(1975), which states, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its transactions and affairs..." It was noted that the policy application files were not available at the home office because they were kept at the producing agency's office.

### Independent Auditor

The Company was audited for the years under examination by the certified public accounting firm of Barfield, Murphy, Shank & Smith, P.C., Birmingham, Alabama. It was noted that Jack Knight, CPA, was the person responsible for the 2004 independent auditor's report and that he had served in that capacity each year since 1992. Alabama Department of Insurance Regulation 482-1-100-.07(4)(a) states, "No partner or other person responsible for rendering a report may act in that capacity for more than seven (7) consecutive years..." The Company did not comply with the aforesaid regulation.



The audit reports and work papers of the independent auditor were reviewed by the examiners. The examiners did not utilize the work performed by the independent auditor.

The independent auditor did not include a review by a qualified actuary of the loss and loss adjustment expense reserves developed by the Company's consulting and opining actuary. The Company's consulting and opining actuary's work was relied upon. The examiners noted that the Company's consulting and opining actuary has been preparing an original work product that has not been subjected to review and/or testing by any independent, qualified third party with the exception of the periodic Alabama Department of Insurance statutory examinations.

As for utilizing a specialist that has a relationship with the client, the AICPA Professional Standards stipulates in Sections 336.10 and 336.11,

The auditor should evaluate the relationship of the specialist to the client, including circumstances that might impair the specialist's objectivity. Such circumstances include situations in which the client has the ability---through employment, ownership, contractual right, family relationship, or otherwise---to directly or indirectly control or significantly influence the specialist. When a specialist does not have a relationship with the client, the specialist's work usually will provide the auditor with greater assurance of reliability. However, the work of a specialist who has a relationship with the client may be acceptable under certain circumstances. If the specialist has a relationship with the client, the auditor should assess the risk that the specialist's objectivity might be impaired. If the auditor believes the relationship might impair the specialist's objectivity, the auditor should perform additional procedures with respect to some or all of the specialist's assumptions, methods, or findings to determine that the findings are not unreasonable or should engage another specialist for that purpose.

The examiners determined that the Company's consulting actuary does have a relationship with the client through employment that may impair the actuary's objectivity. The CPA did not document the assessment of the risk of impaired objectivity or determine the necessity of performing additional procedures with respect to the actuary's assumptions, methods or findings.

### Disclosure of Unusual Transaction

The examination identified a transaction that had all the characteristics of a loan from the Company to its MGA, First Premium Insurance Group (FPIG). The recording of the transaction was identified in the Company's detailed general ledger as a loan. The examination indicated that monthly payments were being received from FPIG reducing the balance. FPIG was charged interest on the balance which was originally \$331,621. A loan amortization schedule was obtained from the Company that indicated each scheduled payment.

Company management represented that the transaction was not a loan, but was an overpayment of contingent commissions. The contingent commissions were expensed when paid. The commissions recovered and interest received was credited against commissions expense when received. Management maintains that the transactions do not involve a loan but are the recovery of contingent commissions. Management contended that the additional amount that is added to the principal is not interest on a loan, but involves a discount for timely repayments.

### Outstanding Checks Were Not Included in Unclaimed Property Reports

It was determined that the Company did not include in its unclaimed property filings outstanding checks that have remained outstanding in excess of five years. The Company's position was that claim payment checks that remain outstanding more than five years are not unclaimed property. The examiners did not agree with the position.

ALA. CODE §35-12-23(b)(1975) identifies unclaimed property as follows. " 'Unclaimed funds', as used in this section, means all moneys held and owing by any insurance corporation unclaimed and unpaid for more than five years after the moneys became due and payable as established from the records of the corporation." As for identifying the unclaimed property that is escheatable to the State of Alabama, ALA. CODE §35-12-23(a)(1975) states, "Unclaimed funds, as defined in this section, held and owing by an insurance corporation shall be presumed abandoned if the last known address, according to the records of the corporation, of the person entitled to the funds is within this state."

### Improper Financial Reporting in Years Prior to 2004

The Company did not complete the Provision for Reinsurance in 2002 and 2003 as required by SSAP No. 62, paragraph 19, and the NAIC Annual Statement Instructions. The Company improperly non-admitted overdue reinsurance recoverables at year-ends 2002 and 2003 rather than account for the recoverables as required in SSAP No. 62, paragraph 19. Proper reporting of the 2002 and 2003 overdue reinsurance recoverables would have resulted in an immaterial increase of the Company's surplus in 2002 and 2003.

## FINANCIAL STATEMENTS

The financial statements included in this report were prepared on the basis of the Company's records, and the valuations and determinations were made during the examination for the year 2004. Amounts shown in the comparative statements for the years 2001, 2002 and 2003 were compiled from the Company's copies of filed Annual Statements. The statements are presented in the following order:

Statement of Assets, Liabilities, Surplus and Other Funds	Page 27
Summary of Operations	Page 28
Capital and Surplus Account	Page 29

**Omega One Insurance Company**  
**Statement of Assets, Liabilities, Surplus and Other Funds**  
**For the Year Ended December 31, 2004**

	<u>Assets</u>		
	Assets	Non- Admitted Assets	Admitted Assets
Bonds	\$ 7,006,149	\$	\$ 7,006,149
Stocks (Common)	2,567,282		2,567,282
Cash and short-term investments (Note 1)	1,093,040		1,093,040
Investment income due and accrued	79,724		79,724
Uncollected premiums and agents' balances in course of Collections (Note 2)	189,192	21,060	168,132
Deferred premiums, agents' balances and installments booked but deferred and not yet due (Note 3)	607,404		607,404
Amounts recoverable from reinsurers (Note 4)	355,728	3	355,725
Electronic data processing equipment and software	3,023	3,023	
Receivables from parent, subsidiaries and affiliates (Note 5)	<u>66,593</u>		<u>66,593</u>
<b>Total Assets</b>	<b><u>\$ 11,968,136</u></b>	<b><u>\$ 24,087</u></b>	<b><u>\$ 11,944,049</u></b>

**Liabilities, Surplus and Other Funds**

<b>Liabilities:</b>		
Losses		\$ 1,900,145
Loss adjustment expenses		159,098
Commissions payable, contingent commission and other similar charges (Note 6)		17,397
Other expenses (excluding taxes, licenses and fees) (Note 6)		74,764
Taxes, licenses and fees (excluding federal and foreign income taxes)		3,905
Current federal and foreign income taxes		88,000
Net deferred tax liability		354,000
Unearned premiums (Note 3)		1,255,820
Ceded reinsurance premiums payable (Note 7)		
Amounts withheld or retained by company for account of others		15,683
Provision for reinsurance (Note 4)		71,142
Drafts outstanding (Note 1)		0
Payable to parent, subsidiaries and affiliates (Note 7)		<u>146,756</u>
<b>Total Liabilities</b>		<b>\$ 4,086,710</b>
<b>Capital and Surplus:</b>		
Common Capital Stock		\$ 650,000
Surplus notes		3,500,000
Gross paid in and contributed surplus		1,000,000
Unassigned funds (Note 8)		<u>2,707,339</u>
<b>Total Capital and Surplus</b>		<b><u>\$ 7,857,339</u></b>
<b>Total Liability and Stockholders' Equity</b>		<b><u>\$ 11,944,049</u></b>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

**OMEGA ONE INSURANCE COMPANY**  
**SUMMARY OF OPERATIONS**  
For the Years Ended December 31, 2001, 2002, 2003, 2004

	2001	2002	2003	2004
<b>Underwriting Income</b>				
Premiums earned	\$ 4,243,287	\$ 5,253,659	\$ 4,761,776	\$ 4,496,253
<b>Deductions:</b>				
Losses incurred	1,689,039	3,011,733	2,615,851	2,772,832
Loss expenses incurred	228,587	407,395	320,378	306,506
Other underwriting expenses incurred	<u>1,692,055</u>	<u>1,850,095</u>	<u>1,728,384</u>	<u>1,263,030</u>
Total underwriting deductions	<u>\$ 3,609,681</u>	<u>\$ 5,269,223</u>	<u>\$ 4,664,612</u>	<u>\$ 4,342,368</u>
Net underwriting gain	\$ 633,606	\$ (15,564)	\$ 97,164	\$ 153,885
<b>Investment Income</b>				
Net investment income earned	\$ 491,408	\$ 494,534	\$ 417,248	\$ 414,558
Net realized capital gains	<u>151,560</u>	<u>149,822</u>	<u>256,696</u>	<u>34,889</u>
Net investment gain	<u>\$ 642,969</u>	<u>\$ 644,356</u>	<u>\$ 673,944</u>	<u>\$ 449,447</u>
<b>Other Income</b>				
Net loss from agents' or premium balances charged off		\$ (4186)		
Finance and service charges not included in premiums	\$ 223,386	333,647	\$ 315,044	\$ 285,899
Aggregate write-ins for miscellaneous income	<u>53,470</u>	<u>83,667</u>	<u>82,973</u>	<u>66,523</u>
Total Other Income	<u>\$ 276,856</u>	<u>\$ 413,128</u>	<u>\$ 398,017</u>	<u>\$ 352,422</u>
Net income before federal and foreign taxes	1,553,431	1,041,920	1,169,124	955,753
Federal and foreign income taxes incurred	<u>505,945</u>	<u>340,356</u>	<u>389,805</u>	<u>289,230</u>
Net income	<u>\$1,047,486</u>	<u>\$ 701,564</u>	<u>\$ 779,319</u>	<u>\$ 666,523</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

**OMEGA ONE INSURANCE COMPANY**  
**CAPITAL AND SURPLUS**  
For the Years Ended December 31, 2001, 2002, 2003, 2004

	2001	2002	2003	2004
Capital and surplus, December 31, prior year	\$ 4,079,130	\$ 5,000,416	\$ 5,655,883	\$ 6,691,377
Net income	1,047,486	701,564	779,319	666,523
Change in net unrealized capital gains or (losses)	(39,062)	(121,299)	399,044	317,318
Change in net deferred income tax	(139,558)	117,630	(140,000)	(137,000)
Change in nonadmitted assets	107,491	(42,428)	(2,869)	34,552
Cumulative effect of changes in accounting principles	(55,071)			
Aggregate write-ins for gains and losses in surplus				284,567
Net change in capital and surplus for the year	921,286	655,467	1,035,494	1,165,960
Capital and surplus, December 31, current year	<u>\$5,000,416</u>	<u>\$ 5,655,883</u>	<u>\$ 6,691,377</u>	<u>\$ 7,857,337</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

## NOTES TO FINANCIAL STATEMENTS

<u>Note 1 – Cash and short-term investments</u>	<u>\$1,093,040</u>
<u>Drafts outstanding</u>	<u>\$ 0</u>

The above captioned amount for "Cash and short-term investments" is \$139,675 less than the amount reported by the Company in its 2004 Annual Statement. The above captioned amount for "Drafts outstanding" is \$139,675 less than the amount reported by the Company in its 2004 Annual Statement.

The examination of the drafts outstanding detail indicated that the account was comprised of outstanding checks rather than outstanding drafts. Accounting personnel indicated that the outstanding checks were reclassified as drafts outstanding when the checks became stale dated. SSAP No. 2, paragraph 7, stipulates, "Outstanding checks are accounted for as a reduction of cash." The outstanding checks were reclassified in the financial statements included in this report. Further discussion of the misclassified outstanding checks is included in this report under the caption "ACCOUNTS AND RECORDS - Outstanding Checks Were Not Included in Unclaimed Property Reports."

The examination of the cash account indicated that five outstanding checks totaling \$1,237 were not included in the reported account balance. The outstanding checks were found to be checks written by field adjustors that were not recorded by the Company until after year end. The overstatement of cash is immaterial and no change is reflected in the financial statements contained in this report.

The Company's repurchase agreement with SouthTrust Bank, N.A., does not specify acceptable types of collateral.

<u>Note 2 – Premiums and considerations:</u>	<u>\$168,132</u>
<u>Uncollected premiums and agents'</u>	
<u>balances in course of collection</u>	

The above captioned amount is the same as reported in the 2004 Annual Statement.

Company officials provided policy detail of all of the balances that became due in October, November and December of 2004 to support their admitted asset at December 31, 2004, but did not provide to the examiners an aging of each of the outstanding receivable balances at December 31, 2004. Company officials



indicated that an aging of each outstanding balance could not be provided to the examiners. The Company is not properly aging its Uncollected premiums and agents' balances in course of collection consistent with SSAP No. 6, paragraph 9(c), which states, "The uncollected agents receivable on a policy by policy basis which is over ninety days due shall be non-admitted regardless of any unearned premium."

The Company could not provide valid evidence of the age of its outstanding balances that comprised the account balance. Therefore, the Company could not provide valid evidence of the admissibility of the asset. The overstatement of the account is \$168,132, which is not material. Due to immateriality, no changes are made to the financial statements included in this report.

<b><u>Note 3 - Unearned Premiums</u></b>	<b><u>\$1,255,820</u></b>
<b><u>Deferred premiums, agents' balances</u></b>	<b><u>\$ 607,404</u></b>
<b><u>and installments booked but deferred</u></b>	
<b><u>and not yet due</u></b>	

The above captioned amounts are the same as reported by the Company in its 2004 Annual Statement.

The examination determined that the Company cut-off date for reporting unearned premiums and deferred premiums, agents' balances and installments booked but deferred and not yet due was December 29, 2004, instead of December 31, 2004.

ALA. CODE §27-3-26(a)(1975) requires that the Company "...file with the commissioner a full and true statement of its financial condition, transactions and affairs as of the December 31, preceding."

The examination indicated that no material adjustment would result from reporting the accounts on the calendar year basis. Therefore, no changes were made to the financial statement contained in this report.

The Company utilized the monthly pro rata method to calculate its unearned premium reserves for one segment of its business and the daily pro rata method for another segment of its business. The SSAP No. 53, paragraph 7 states, "One of the following methods shall be used for computation of the unearned premium reserve: ...Daily pro rata method...Monthly pro rata method."

<b><u>Note 4 – Reinsurance: Amounts recoverable</u></b>	<b><u>\$355,725</u></b>
<b><u>from reinsurers</u></b>	
<b><u>Provision for reinsurance</u></b>	<b><u>\$ 71,142</u></b>

The above captioned amount for “Reinsurance: Amounts recoverable from reinsurers” is \$355,709 more than the \$16 reported by the Company in its 2004 Annual Statement. The above captioned amount for “Provision for reinsurance” is \$71,142 more than the \$0 reported by the Company in its 2004 Annual Statement.

The change, in the amount of \$355,709, in the “Reinsurance: Amounts recoverable from reinsurers” is amounts due the Company from its sole shareholder, National Security Fire & Casualty Company (NSF&C). The amount is owed the Company for losses and loss adjustment expenses related to CAT Occurrence 74 which occurred in October 2002. The Company has not collected the amount that is owed under its reinsurance agreement with NSF&C.

The change, in the amount of \$71,142, in the “Provision for reinsurance” is the amount that the Company is required to record in relation to its aged reinsurance recoverable in accordance with the NAIC Annual Statement Instructions.

<b><u>Note 5 - Receivables from parent, subsidiaries</u></b>	<b><u>\$66,593</u></b>
<b><u>and affiliates</u></b>	

The above captioned amount is the same as reported in the Company’s 2004 Annual Statement.

The Company incorrectly identified a receivable from an affiliate as a payable to an affiliate in the Annual Statement Notes to Financial Statements each year from 2001 to 2004.

<b><u>Note 6 – Commissions payable, contingent</u></b>	<b><u>\$17,397</u></b>
<b><u>commissions and other similar charges</u></b>	
<b><u>Other expenses</u></b>	<b><u>\$74,764</u></b>

The above captioned amounts are the same as reported in the Company’s 2004 Annual Statement.

The Company included agents' commissions payable of \$32,436 in the line item "Other expenses." According to the NAIC Annual Statement Instructions the payable is to be reported in the line item "Commissions payable, contingent commissions and other similar charges." The misclassification has no effect on surplus. No changes were made to the financial statements.

<b><u>Note 7 – Payable to parent, subsidiaries and affiliates</u></b>	<b><u>\$146,756</u></b>
<b><u>Ceded reinsurance premiums payable</u></b>	<b><u>\$ 0</u></b>

The above captioned amounts are the same as reported in the Company's 2004 Annual Statement.

The Company included a ceded reinsurance payable of \$91,919 that it owed its parent, National Security Fire & Casualty Company, in the line item "Payable to parent, subsidiaries and affiliates." The NAIC Annual Statement Instructions indicate that ceded reinsurance premiums in the course of collection are to be reported in the line item "Ceded reinsurance premiums payable." The misclassification has no effect on surplus. No changes were made to the financial statements.

<b><u>Note 8 – Unassigned Funds</u></b>	<b><u>\$2,707,339</u></b>
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The above captioned amount is \$284,567 more than the \$2,422,772 reported by the Company in its 2004 Annual Statement. The following is a reconciliation of unassigned funds per this examination:

Unassigned funds per Company		\$2,422,772
Examination increase/(decrease) to assets:		
Cash and short-term investments	\$(139,675)	
Reinsurance: Amounts recoverable from reinsurers	\$ 355,709	
Examination (increase)/decrease to liabilities:		
Provision for reinsurance	\$ (71,142)	
Drafts outstanding	\$ 139,675	
Change in Unassigned funds	\$ 0	\$ 284,567
Total Unassigned funds per examination		\$2,707,339

## **COMMENTS AND RECOMMENDATIONS**

### **Committees – Page 5**

**It is recommended** that the Company keep minutes of its Investment Committee meetings as required by ALA. CODE §10-2B-16.01(a)(1975), which states,

A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.

### **Conflict of Interest – Page 8**

**It is recommended** that all officers and directors of the Company file conflict of interest statements each year in order to ensure compliance with the Annual Statement General Interrogatory requirement of disclosing all conflicts of interest.

### **Holding Company and Affiliate Matters – Page 8**

**It is recommended** that the Company cease the practice of making loans to its sole shareholder. Loans to controlling stockholders are prohibited by ALA. CODE §27-41-36, which states,

An insurer shall not invest in nor lend its funds upon the security of any note or other evidence of indebtedness of any director, officer or controlling stockholder of the insurer, except as to policy loans authorized under Section 27-41-25 and except as provided in Sections 27-1-2, 27-27-26 and 27-37-2 of the Alabama Insurance Code.

**It is recommended** that the Company obtain the approval of the Commissioner at least 30 days prior to making a loan that exceeds the statutory stated threshold to an affiliate within the Company's holding company system as required by ALA. CODE §27-29-5(b)(1)(a)(1975), which states,

The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer

has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period. (1) Sales, purchases, exchanges, loans or extensions of credit, guarantees, or investments provided the transactions are equal to or exceed: (a) With respect to nonlife insurers, the lesser of three percent of the insurer's admitted assets or 25 percent of surplus as regards policyholders as of the 31st day of December next preceding.

**It is recommended** that the Company require its affiliate debtors to adhere to the loan repayment terms stipulated in the respective loan agreements with the Company.

#### **Fidelity Bond and Other Insurance – Page 12**

**It is recommended** that the Company maintain fidelity bond coverage of an amount that is at least as much as the minimum amount suggested by the NAIC Financial Condition Examiners Handbook.

#### **Policy Forms and Underwriting – Page 14**

**It is recommended** that the Company maintain its files and documentation in accordance with ALA. CODE §27-27-29(a)(1975), which states, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

#### **Claims Review – Page 16**

**It is recommended** that the Company maintain proper documentation to evidence the claim resolution decision made as required by ALA. ADMIN. CODE 482-1-125.-04, which states, "The insurer shall maintain claim files that are accessible and retrievable for examination... This data must be available for all open and closed files for the current year and the five (5) preceding years, in order to permit reconstruction of the insurer's activities relative to each claim."

### **Compliance with Agents' Licensing Requirements – Page 17**

**It is recommended** that the Company make certain that its managing general agent is properly licensed as required by ALA. CODE §27-6A-3(b)(1975), which states,

No person, firm, association, or corporation shall act in the capacity of a managing general agent representing an insurer domiciled in this state with respect to risks located outside this state unless then licensed in this state as a managing general agent of the insurer. Where applicable, the license may be a nonresident license pursuant to this chapter.

### **Catastrophe Reinsurance Agreement with National Security Fire & Casualty Company (NSF&C) – Page 19**

**It is recommended** that the Company revise its reinsurance agreement with NSF&C to include a provision for premiums and losses and payment of losses reporting as specified by SSAP No. 62, paragraph 8(d), and an errors and omissions clause.

**It is recommended** the Company require National Security Fire & Casualty Company to reimburse the Company for the covered losses under the catastrophe reinsurance agreement with National Security Fire & Casualty Company for losses incurred for CAT Occurrence 74. It is further recommended that the Company require National Security Fire & Casualty Company to comply with the terms of the reinsurance agreement.

### **Accounts and Records – Page 22**

**It is recommended** that the Company maintain complete records of its transactions and affairs, including the policy application files, at its home office in accordance with ALA. CODE §27-27-29(a)(1975), which states, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its transactions and affairs..."

**It is recommended** that the Company include its outstanding checks that are issued to payees with last known addresses in Alabama that have been outstanding over five years in its Alabama unclaimed property filing. Such checks are deemed unclaimed property in accordance with ALA. CODE §35-12-23(b), which states, " 'Unclaimed funds', as used in this section, means all

moneys held and owing by any insurance corporation unclaimed and unpaid for more than five years after the moneys became due and payable as established from the records of the corporation.” It is further recommended that the Company properly escheat the unclaimed property of other states to the respective states as well.

**It is recommended** that the Company employ a different CPA than the one that has been responsible for the independent auditor’s report for each year from 1992 to 2004 to remedy the Company’s failure to comply with Alabama Department of Insurance Regulation 482-1-100-.07(4)(a), which states, “No partner or other person responsible for rendering a report may act in that capacity for more than seven (7) consecutive years...”

**It is recommended** that the Company require its CPA to evaluate the Company’s relationship with the consulting and opining actuary to determine whether the actuary’s work is to be relied upon for the independent audit as required by AICPA Professional Standards Sections 336.10 and 336.11, which state,

The auditor should evaluate the relationship of the specialist to the client, including circumstances that might impair the specialist’s objectivity. Such circumstances include situations in which the client has the ability---through employment, ownership, contractual right, family relationship, or otherwise---to directly or indirectly control or significantly influence the specialist. When a specialist does not have a relationship with the client, the specialist’s work usually will provide the auditor with greater assurance of reliability. However, the work of a specialist who has a relationship with the client may be acceptable under certain circumstances. If the specialist has a relationship with the client, the auditor should assess the risk that the specialist’s objectivity might be impaired. If the auditor believes the relationship might impair the specialist’s objectivity, the auditor should perform additional procedures with respect to some or all of the specialist’s assumptions, methods, or findings to determine that the findings are not unreasonable or should engage another specialist for that purpose.

**It is recommended** that the Company complete the Provision for Reinsurance for any overdue reinsurance recoverables as required by SSAP No. 62, paragraph 19, and the NAIC Annual Statement Instructions.

### **Cash and short-term investment and Drafts outstanding – Page 30**

**It is recommended** that the Company account for all outstanding checks as a reduction of cash in accordance with SSAP No. 2, paragraph 7, which stipulates, “Outstanding checks are accounted for as a reduction of cash.”

**It is recommended** that the Company account for all outstanding items in the Cash and short-term investments balance that it reports in its Annual Statement.

**It is recommended** that the Company amend its repurchase agreement with SouthTrust Bank, N.A., to specify acceptable types of collateral.

### **Premiums and consideration: Agents' balances and uncollected premiums in course of collection – Page 30**

**It is recommended** that the Company properly nonadmit all agents' balances and uncollected premiums in course of collection that are over 90 days past due in accordance with SSAP No. 6, paragraph 9(c), which states, “The uncollected agents receivable on a policy by policy basis which is over ninety days due shall be non-admitted regardless of any unearned premium.”

### **Unearned Premiums and Deferred premiums, agents' balances and Installments booked but deferred and not yet due – Page 31**

**It is recommended** that the Company report all of its balances as of December 31 in future Annual Statement filings in accordance with ALA. CODE §27-3-26(a)(1975), which requires the Company to “...file with the commissioner a full and true statement of its financial condition, transactions and affairs as of the December 31, preceding.”

**It is recommended** that the Company use one of the allowed methods to calculate its unearned premium reserves in accordance with SSAP No. 53, paragraph 7, which states, “One of the following methods shall be used for computation of the unearned premium reserve: ...Daily pro rata method...Monthly pro rata method.”

### **Receivables from parent, subsidiaries and affiliates – Page 32**

**It is recommended** that the Company accurately disclose its balances with affiliates in the Annual Statement Notes to Financial Statements.



**Commissions payable, contingent commissions and other similar charges and Other expenses – Page 32**

It is recommended that the Company properly classify all agents' commissions payable as "Commissions payable, contingent commissions and other similar charges" in its Annual Statement in accordance with the NAIC Annual Statement Instructions.

**Payable to parent, subsidiaries and affiliates and Ceded reinsurance premiums payable – Page 33**

It is recommended that the Company report all of its ceded reinsurance premiums payable, including ceded reinsurance premiums payable to its parent, National Security Fire & Casualty Company, in the line item "Ceded reinsurance premiums payable" in accordance with the NAIC Annual Statement Instructions that indicate that ceded reinsurance premiums in the course of collection are to be reported in the line item "Ceded reinsurance premiums payable."

**Compliance with Previous Recommendations – Page 39**

It is recommended that the Company comply with the Report of Examination recommendations.

**CONTINGENT LIABILITIES AND PENDING LITIGATION**

The review of contingent liabilities and pending litigation included an inspection of representations made by management and a general review of the Company's records and files conducted during the examination, including a review of claims. These reviews did not disclose any items that would have a material effect on the Company's financial condition in the event of an adverse outcome.

**COMPLIANCE WITH PREVIOUS RECOMMENDATIONS**

A review was performed to determine if the Company had complied with the recommendations made in the last examination report. The review indicated that the Company had complied with the recommendations contained in the

immediately preceding Report of Examination with the exception of the items listed below.

The previous Report of Examination recommended that the Company maintain complete and accurate records of its assets, transactions and affairs. The current examination noted numerous instances in which the Company did not maintain complete and accurate records of its assets transactions and affairs.

The previous Report of Examination included a comment that loans to controlling stockholders are nonadmitted. The current examination noted that the Company has continued to loan to its sole shareholder during the examination period.

### **SUBSEQUENT EVENTS**

The review of events subsequent to December 31, 2004, did not reveal anything material in amount or noteworthy in nature.

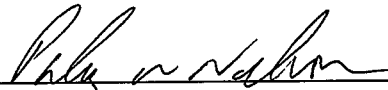
## CONCLUSION

Acknowledgement is hereby made of the courtesy and cooperation extended by all persons representing Omega One Insurance Company during this examination.

The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Toni Bean, Angie Block, Douglas Brown, Laura Chapman, Bobby McKinnon, Felicia McKinzy, Alfonzo Nunn and Thomas Salo, Examiners; and Glenn Taylor, ACAS, MAAA, and Randall Ross, ACAS, MAAA of Taylor Walker & Associates, Consulting Actuary; all representing the Alabama Department of Insurance, participated in this examination of Omega One Insurance Company.

Respectfully submitted,



Palmer W. Nelson, CFE

Examiner-in-charge

Alabama Department of Insurance  
Southeastern Zone, NAIC